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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936

No. 285

UNITED STATES EX RELATIONE GIRARD TRUST COMPANY, Trustee Under the Will of John A. Brown, Jr., Deceased,
Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia.

BRIEF FOR PETITIONER.

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v.

GUY T. HELVERING, Commissioner of Internal Revenue.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia.

BRIEF FOR PETITIONER.

OPINIONS BELOW.

There was no opinion by the Supreme Court of the District of Columbia. The opinion of the Court of Appeals (R. 33-40) is reported in 85 F. (2d) 230.

JURISDICTION.

The judgment of the Court of Appeals was entered May 18, 1936 (R. 40). The petition for a writ of certiorari was filed August 14, 1936, and granted March 15, 1937 (R. 42). The jurisdiction of this court rests on section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (U. S. C. A., Tit. 28, sec. 347 (a)).

STATEMENT OF THE CASE.

Petitioner (relator below) seeks review of a decision of the United States Court of Appeals for the District of Columbia, rendered May 18, 1936 (R. 40), affirming the judgment of the Supreme Court of the District of Columbia, dismissing a petition for mandamus brought to compel the Commissioner of Internal Revenue to refund overpayments of income taxes in amounts determined by the Board of Tax Appeals. The defense interposed and sustained by the court below was a plea that it would be inequitable to compel refund of these overpayments to the petitioner because a beneficiary of the trust estate had received erroneous refunds of her income taxes for some of the years involved, as well as for other years, and had failed to pay taxes due for one of these years, the government being barred by the statute of limitations from recovering such erroneous refunds and from collecting such taxes.

The material facts are as follows:

Petitioner is trustee under the will of John A. Brown, Jr., deceased, who died July 17, 1919, a resident of Newtown Township, Pennsylvania, leaving a last will and codicil thereto, by the terms of which his residuary estate was bequeathed to petitioner, in trust, to collect the income and, after payment of certain expenses, to distribute the net, to the extent of $200,000 per year, to his widow, Harriet Etting Brown, for life, and any excess above that amount to his children (R. 2-3, 17), if any, and if none, to certain nieces and nephews (R. 8-9, 15).

Decedent's widow duly elected to take under the will in lieu of taking the interest otherwise allowed her by the Pennsylvania law, and the property was delivered to petitioner upon the trusts named in December, 1920, since which time it has continued to act as such trustee (R. 3, 17).

During the years 1924 to 1930, inclusive, petitioner currently distributed to the widow the entire net income of the trust estate. Pursuant to the requirements of Section 219 of the Revenue Act of 1924 and corresponding provisions of the 1926 and 1928 Acts (see Appendix, p. 27), petitioner duly filed with the Collector of Internal Revenue a return of income for the trust estate for each of such years, deducting from the gross income the amounts so distributed to the widow. The widow, in turn, in her income tax returns, reported all such distributions for the years 1924 to 1927, inclusive, and paid taxes thereon. For the years 1928 to 1930, inclusive, she did not include such distributions in her taxable income, and the Commissioner did not require her to do so (R. 3, 17, 24).

On March 15, 1929, the Commissioner of Internal Revenue, pursuant to the provisions of Section 274 of the Revenue Act of 1926, notified petitioner of alleged deficiencies in income taxes of the trust estate for the years 1924 and 1925, resulting from the Commissioner's disallowance of the deduction of amounts so distributed to the widow. Petitioner, on May 11, 1929, duly filed with the United States Board of Tax Appeals an appeal from the Commissioner's determination in this regard. The Board on June 23, 1931, entered a decision sustaining the Commissioner's determination that such deductions should be denied, and computing the resulting deficiencies at $30,278.28 for 1924 and $16,580.85 for 1925. Petitioner, on December 21, 1931, filed with the United States Circuit Court of Appeals for the Third Circuit a petition for review of the Board's decision, and on April 26, 1933, the appellate court reversed the Board (R. 3-4, 18). Meanwhile, pending review, petitioner on February 10, 1932, had paid the amounts determined as

deficiencies by the Board, together with interest of $18,279.01 (R. 4, 18), in lieu of filing a bond to stay collection, under the provisions of Section 1001 of the Revenue Act of 1926 (see Appendix, p. 28).

Pursuant to the mandate of the appellate court, the Board on July 7, 1934, entered its decision, wherein it ordered and decided that there were no deficiencies due from petitioner for 1924 or 1925, but that in fact, there were overpayments for such years in the respective amounts paid on February 10, 1932 (R. 4, 18). That decision became final on August 7, 1934, under the provisions of Section 1005 of the 1926 Act (see Appendix, p. 29).

A similar deficiency notice was sent petitioner on January 22, 1931, asserting a deficiency for the year 1928. On March 6, 1931, petitioner appealed to the Board of Tax Appeals, which entered its decision, on stipulation of the parties, on September 29, 1934, determining that petitioner had overpaid its taxes for that year in the amount of $4,376.29. No petition for review of that decision was filed (R. 4, 5, 18-19), and it became final on December 29, 1934, under section 1005, *supra* (see Appendix, p. 29).

There are no income, war-profits, or excess-profits taxes, or instalments thereof, due from petitioner, as such trustee, for any year or period (R. 5, 19, 23-25), against which respondent could credit these overpayments. Nevertheless, respondent refused to refund the overpayments in question. Petitioner's petition for mandamus seeks to compel him to do so. In answer to the petition, respondent denied the Court's jurisdiction (R. 21-22), and defended his failure to refund the overpayments by asserting that such refund would be contrary to equity and good conscience. This defense is based upon the following facts (R. 23-25):

The widow received income from the trust, as aforesaid, and for the years 1924 to 1927, inclusive, paid income taxes thereon. However, she later filed claims for refund of most of the taxes so paid, on the ground that, as a matter of law, this income represented the return to her of the value of

her dower and statutory rights, which she had relinquished when she elected to take under decedent's will, and therefore was not taxable income in her hands. The Commissioner of Internal Revenue considered these claims and allowed substantially, though not exactly, the amounts claimed, refunding to her on September 17, 1931, an aggregate of $60,636.12 as taxes paid on such income for the years 1924 to 1927, inclusive, together with statutory interest thereon. Of this amount, the refund of tax for 1924 was $24,807.99 and for 1925 $11,903.18.

During 1928, the widow received income from the trust, but in good faith did not treat it as taxable in her return. If it had been included, the tax thereon would have been $4,376.39. The Commissioner and his agents examined this return and, with full knowledge of the facts, accepted it as correct (R. 24).

Respondent avers that the Commissioner's action in refunding taxes to the widow for the years 1924 to 1927, inclusive, and in approving her 1928 return, resulted from an error of law on his part, honestly concurred in by the widow; that she has been unjustly enriched by reason of these circumstances; that she and the petitioner "are the same parties in interest"; that the relief herein prayed, if granted, would inure to her sole benefit; and that, in equity and good conscience, respondent should not be directed to refund to petitioner any amount in excess of the amounts now alleged to be justly due and owing from the widow (R. 25).

A demurrer to the answer (R. 26-29) was overruled by the trial court and, the petitioner electing to stand thereon, the petition was dismissed (R. 29). On appeal, the Court of Appeals, while overruling respondent's objections to the jurisdiction (R. 35-37), sustained the validity of the last-mentioned plea and affirmed the order of dismissal (R. 40-41).

SPECIFICATION OF ERRORS.

(1) The Court of Appeals erred in holding that a trustee is not entitled to a writ of mandamus commanding the Commissioner of Internal Revenue to refund overpayments of income tax found to be due it by final decisions of the Board of Tax Appeals, if it appears that a beneficiary of the trust, with the acquiescence of the United States, in good faith, and without intent to defraud, obtained erroneous refunds of income tax for some years and failed to pay income tax for other years, which in the aggregate exceed the amount of the overpayments due the trustee and which are barred from recovery from the beneficiary by the applicable statutes of limitations.

(2) The Court of Appeals erred in holding that a claim of the United States to recover erroneously refunded income tax, which is barred from collection by the statute of limitations, may be set off against a valid claim for refund of income tax for a different taxable year.

(3) The Court of Appeals erred in holding that a court may disregard statutory limitations on the assessment and collection of taxes and recovery of erroneous refunds of taxes, because it believes that the observance of such limitations would be inequitable, there being no charge of fraud or bad faith on the part of the taxpayer.

(4) The Court of Appeals erred in holding that, where a taxpayer, in lieu of filing bond, pays a deficiency determined by the Board of Tax Appeals pending review of the Board's decision by a circuit court of appeals, and where the court disallows the deficiency so determined by the Board, the Commissioner may not be required to refund such payment to the taxpayer.

(5) The Court of Appeals erred in holding that after a final decision of the Board of Tax Appeals that a taxpayer has overpaid taxes, the Commissioner may, in a proceeding

against him to require refund of such overpayments, defeat such refund on grounds not asserted before the Board.

(6) The Court of Appeals erred in holding that a valid claim for refund of overpayments of income taxes by a trustee, in its fiduciary capacity, may be set off or credited against a claim of the government against a beneficiary of the trust.

(7) The Court of Appeals erred in affirming the judgment of the Supreme Court of the District of Columbia.

QUESTION PRESENTED.

Whether the refusal by the Commissioner of Internal Revenue to refund to a trustee admitted overpayments of income tax is justified by a showing that the government once had claims for erroneous refunds and for taxes against a beneficiary of the trust, which claims the government is precluded from collecting under the applicable statutes of limitation.

STATUTES INVOLVED.

The statutes involved, and the proposition for which each is cited, appear in the Appendix, *infra*, pp. 27-31.

SUMMARY OF ARGUMENT.

1.

Where the Board of Tax Appeals sustains a deficiency in income taxes determined by the Commissioner and the taxpayer, in appealing to a Circuit Court of Appeals pays the deficiency instead of posting a bond, the deficiency so paid must be credited or refunded, upon reversal by the court of the Board's decision. Likewise, where the Board of Tax Appeals, by final decision, determines that the taxpayer has made an overpayment of income taxes, the amount of such overpayment must be credited or refunded if not barred by the statute of limitations. If no other income taxes are due

from the taxpayer, the overpayment, in each instance, must be refunded. The duty of the Commissioner of Internal Revenue to make such refund is mandatory, and should be compelled by mandamus, unless the government has a valid claim against the taxpayer which may be set off against such refund.

2.

The defense interposed may not be sustained, because founded upon alleged claims of the government against a separate taxpayer, not a party to this suit. For tax purposes, the federal statutes deal with trustee and beneficiary as separate entities, and an overpayment by one may not be credited or offset against a deficiency due from the other, nor made the excuse for refusing refund of such overpayment under the guise of set-off, recoupment or equitable defense.

3.

Even if the taxing statutes did permit the separate identity of trustee and beneficiary to be ignored, the respondent's defense would be invalid under other statutory provisions which prohibit the collection, either directly or indirectly, of claims for taxes or erroneous refunds after the expiration of specified periods of limitation. Congress also has decreed that collections made in violation of such prohibition must be refunded without regard to any supposed "equities" arising from the fact that the tax was at one time due. Respondent thus asks the court to sanction the indirect collection of stale claims which, if collected directly, he would be required to refund. This plea does not meet the tests required of a plea of set-off or recoupment, and is invalid as an equitable defense. A court may not disregard statutory limitations simply because it appears to the court that the observance of such limitations would produce inequitable results.

4.

Under the procedure prescribed for review of decisions of the Board of Tax Appeals, the taxpayer who loses his case in the Board is given the choice of staying collection pending review by the filing of a bond, or paying the money pending the court's decision. If he adopts the first procedure, a reversal by the court satisfies the condition of the bond. If he adopts the second method, the statute requires refund of his money without the filing of claim. The decision below holds that selection of the second method gives the Commissioner a right, which he could not possibly possess if the first method were adopted, to convert the money to a use not contemplated by the parties nor mentioned in the statute. The adoption of such a rule gives the Commissioner power to make illegal assessments at will whenever he deems it advisable to effect such an oblique collection of a barred tax.

ARGUMENT.

I.

The Commissioner's Duty to Refund the Overpayments Made by Petitioner is Mandatory.

As has been stated, all of the income of this trust has been currently distributed by petitioner, as trustee, to Mrs. Brown. Pursuant to the provisions of sections 219 and 227 of the Revenue Act of 1924, and corresponding provisions of the 1926 and 1928 Acts, petitioner has duly filed returns each year, reporting the gross income and deductions of the trust, the latter including amounts distributable to the beneficiary. Such distributable amounts are deductible by the trustee, *Helvering* v. *Butterworth*, 290 U. S. 365.

However, for the years 1924, 1925 and 1928, the Commissioner denied petitioner's right to deduct these amounts and proposed to assess the trustee with income taxes on the resulting net income. Pursuant to statute, petitioner appealed to the Board of Tax Appeals from this determina-

tion by the Commissioner. In the 1924-1925 appeal, the Board sustained the Commissioner, (23 B. T. A. 1451) and petitioner appealed to the Circuit Court of Appeals for the Third Circuit, which reversed the Board and disallowed the deficiencies found by the Board (R. 3, 4, 18).

Meanwhile, pending the determination of its appeal to the court, petitioner paid the deficiencies (with statutory interest), in lieu of filing bond. Under the plain provisions of section 1001(d) of the Revenue Act of 1926 (Appendix, p. 29), it became the duty of the Commissioner of Internal Revenue (see Sec. 3220, R. S.; Title 26, U. S. C. A. (1925 Ed.), Sec. 149) immediately after the court's decision, to credit the amounts so paid against any income taxes then due from petitioner and to refund the balance. Although admitting that there were no such taxes then due from petitioner (R. 5, 19, 23-25), the respondent refuses to refund.

In the 1928 case, the Board of Tax Appeals determined that petitioner had made an overpayment of $4,376.39, and that such overpayment had been made within two years before the petition was filed. Under the provisions of section 322(d) of the Revenue Act of 1928 (Appendix, p. 30), the respondent was then required to credit or refund such overpayment to the petitioner, but he refuses to do so.

The only excuse offered by respondent for his refusal to make these refunds, is that it would be inequitable to refund moneys which would inure to the sole benefit of the widow beneficiary of this trust, against whom he has certain unenforceable claims. Unless that excuse be a valid defense, petitioner is entitled to the relief prayed for, as the court below so clearly demonstrated (R. 35-37).[1]

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[1] The court below expressly held (R. 36) that the finding of the Board of Tax Appeals made mandatory the duty of the Commissioner to make the refund; that the statute authorizing refunds did not involve the exercise of discretion and that mandamus is an appropriate remedy, because nothing that the petitioner could obtain from a judgment in the Court of Claims or the District Court would be any more adequate or specific. The Court nevertheless denied the writ because "the writ of mandamus is not a writ of right, but is awarded only in the exercise of a sound judicial discretion and to compel the perform-

II.

The Defense is Not Available in This Case Because it is Based Upon Claims Against Another Taxpayer, Who is Not a Party to This Suit.

(a) Trustee and beneficiary are separate taxpayers, and the law forbids the crediting of overpayments of one against obligations of the other.

Under section 219 of the Revenue Act of 1924 (Appendix, p. 27) identical in substance with corresponding provisions of all Revenue Acts since 1918,[2] the same tax rates are imposed upon the income of estates or trusts as upon the income of individuals. The trustee pays the tax, but in computing the taxable net income of the trust, he deducts the amount of trust income which is to be distributed currently under the terms of the trust instrument, and such amount (like partnership income)[3] must be included by the beneficiary in his return, whether actually distributed or not. The statutes define a "taxpayer" as "any person subject to" the income tax, and define "person" as "an individual, a trust, or estate, a partnership, or a corporation." (Appendix, p. 28)

There can be no doubt, then, that a trust and its beneficiary each is a "taxpayer", making his own return and claiming and receiving his own appropriate deductions. *Anderson* v. *Wilson*, 289 U. S. 20; *Hartley* v. *Commissioner*, 295 U. S. 216. See also, *Sawtell* v. *Commissioner*, 82 F. (2d) 221, 222 (C. C. A. 1st) where the court said:

> "The basic plan of the statute is that income of property held in trust shall be taxed to the fiduciary. The

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ance of an act which in equity and good conscience ought to be performed", (R. 37).

However, it is well settled that judicial discretion cannot be used as the basis for the refusal to enforce or observe a valid statute. *Ex Parte United States*, 242 U. S. 27, 42, 44; *Ex Parte United States*, 287 U. S. 241, 250, 251; *Miguel* v. *McCarl*, 291 U. S. 442. See also comment on the decision below appearing in 37 Columbia Law Rev., pp. 146-8.

[2] Section 219 of the 1918, 1921 and 1926 Acts, and Sections 161-162 of the 1928 and subsequent acts.

[3] See, for example, Sec. 218 of the Revenue Acts of 1924 and 1926.

> fiduciary is regarded for purposes of taxation as the legal owner of the property and of the income."

In *Anderson* v. *United States*, 15 F. Supp. 216, 223 (Ct. Cl.), the Court of Claims said:

> "Under the federal taxing acts an estate is a distinct taxable entity and is placed in the same class as other taxpayers • • •."

To the same effect are *Baltzell* v. *Mitchell*, 3 F. (2d) 428 (C. C. A. 1st) cert. den. 268 U. S. 690 and *Abell* v. *Tait*, 30 F. (2d) 54 (C. C. A. 4th), cert. den. 279 U. S. 849.

The earliest administrative ruling on the subject of forbidding the crediting of overpayments of one taxpayer against the liability of another, under such circumstances, appears to be *I. T. 2020*, reported in *Internal Revenue Cumulative Bulletin III-1* (1924), at page 348. There the executor of an estate was also the sole beneficiary. For the year 1918, he overpaid his individual income tax, and, when an additional tax was assessed against the estate for the same year, the question arose as to whether the overpayment could be credited against the deficiency due from the estate. In the ruling cited, it was held that such a credit would be invalid, because an overpayment may be credited only to the taxpayer making the payment and that the individual, though sole beneficiary of the estate, was not the same taxpayer as the executor. The soundness of this rule has been recognized, not only by the repeated re-enactment of the statute, but by the overwhelming weight of authority:

> *Roebling* v. *Commissioner*, 28 B. T. A. 644, 656, rev'd on other grounds, 78 F. (2d) 444 (C. C. A. 3rd).
> *Anderson* v. *Wilson*, 289 U. S. 20, 27.
> *Hulburd* v. *Commissioner*, 296 U. S. 300.
> *Wynne* v. *Commissioner*, 77 F. (2d) 473 (C. C. A. 5th).
> *Commissioner* v. *Owens*, 78 F. (2d) 768, 776 (C. C. A. 10th).

[redacted] v. Commissioner (C.C.A. 9th, April 12, 1937) C.C.H. Fed. Tax Serv., par. 9045.

(b) The defense is insufficient as a plea of set-off or recoupment.

The Court of Appeals conceded that there was no basis for a set-off and refrained from discussion of the sufficiency of the defense as a plea of recoupment (R. 37). However, the designation of the same kind of defense in other cases as a plea of set-off or recoupment makes it desirable to discuss those questions.

The same kind of defense was sustained in *White* v. *Stone*, 78 F. (2d) 136 (C. C. A. 1st)[4] and in *First National Bank of Birmingham* v. *United States*, 12 F. Supp. 301 (D. C., N. D. Ala.)[5], but was overruled in *United States* v. *Arnold, et al., Trustees* (decided by U. S. Circuit Court of Appeals for the Third Circuit February 4, 1937) 373 C. C. H. 1937 Fed. Tax Serv. ¶ 9092, and in *Union Trust Company of Pittsburgh, Trustee*, v. *United States* (D. C., W. D. Pa., Feb. 9, 1937), 373 C. C. H. 1937 Fed. Tax Serv. ¶ 9102.

In the *White* case, the defense was sustained as a plea of set-off under what the court believed to be general principles of the law of contracts and under a Massachusetts statute. In the *First National Bank* case, a similar defense was sustained on the broad ground that, although trust and beneficiary are treated as separate taxable entities by the tax laws, equity requires that an amount paid by a trustee in discharge of a tax improperly imposed upon the trust, be "treated and retained" by the government "as in part discharge" of a barred tax liability of the beneficiary.

In the *Arnold* case, the same sort of defense was considered as a plea of estoppel and overruled, the court saying that the neglect or refusal of the taxing authorities to assess the beneficiary "would not make the estate or any one else taxable who otherwise would not be." In the *Union Trust Company* case, the same defense was denom-

[4] Pending in this court as *Stone* v. *White*, No. 202, October Term, 1935.

[5] Pending on appeal, United States Circuit Court of Appeals, Fifth Circuit.

inated a "recoupment defense" and overruled on the authority of the decision in the *Arnold* case.

To sustain a plea of set-off or recoupment, the claims of plaintiff and defendant must be mutual and subsisting between the same parties, acting in the same capacity or right. *Manhattan Life Insurance Co.* v. *McKown*, 90 Fed. 646 (C. C. A. 3rd)—same case below, 91 Fed. 352 (C. C., W. D. Pa.); *Jewett* v. *Martinsville Milling Co.*, 76 F. (2d) 153 (C. C. A. 7th).

Obviously, if the separate identity of trust and beneficiary is to be respected, the adverse claims in this case are not mutual. Neither the respondent nor his principal has ever had a claim against this petitioner for either the 1928 taxes of the beneficiary or the erroneous refunds made to her for other years. As to the 1928 taxes section 162 (c) of the Revenue Act of 1928 (Appendix, p. 27) makes the beneficiary alone liable. An assessment against the trustee is not an assessment against the beneficiary either in substance or in form, 37 *Col. Law Rev.*, p. 148. Cf. *Hulburd* v. *Commissioner*, 296 U. S. 300. As to the obligation to return erroneous refunds, that is quasi-contractual and enforceable only against the person to whom the refunds were made. *United States* v. *Hart*, 12 F. Supp. 596. (D. C., E. D. Pa.)

(c) The plea is insufficient as an equitable defense.

The only basis suggested for taking this case out of the rule that a set-off or recoupment may not be based upon a claim against one who is not a party to the action, is the allegation that the trustee and beneficiary herein "are the same parties in interest" and that "any relief prayed herein and granted will inure to the sole benefit of" the beneficiary, Mrs. Brown (R. 25). But an attempted set-off of this kind has been held invalid in the case of parent and subsidiary corporations (*Ford Motor Company* v. *United States*, 9 F. Supp. 590, 601, 602) (Ct. Cl.); cert. den-

296 U. S. 636); of two corporations with common stock ownership (*Hart Glass Manufacturing Co.* v. *United States*, 48 F. (2d) 435, 442) (Ct. Cl.); cert. den. 286 U. S. 536); of a corporation and its sole individual stockholder (*United States* v. *S. F. Scott & Sons*, 69 F. (2d) 728) (C. C. A. 1st); of taxpayer and transferee (*Hamilton Web Co.* v. *Page*, 8 F. Supp. 626, 633) (D. C., R. I.); of lessor and lessee where the lessee was obligated by contract to pay the lessor's taxes (*Philadelphia Rapid Transit Co.* v. *United States*, 10 F. Supp. 591, (Ct. Cl.) cert. den. March 2, 1937); and of an executor in his capacity as such, on the one hand, and as residuary legatee on the other (*Hulburd* v. *Commissioner*, 296 U. S. 300; *Ida Stephenson*, 33 B. T. A. 249). Yet, in each of these cases the result was no less "inequitable" than would be the refunds here demanded, in that the result inured to the benefit of the real party in interest, against whom the government had other claims. In *Anderson* v. *Wilson, supra*, in holding that the income beneficiary of a trust could not deduct, for tax purposes, a loss incurred by the trust on the sale of assets, this court held that equitable considerations do not justify a departure from the rule (289 U. S. 27):

> "• • • In so ruling we do not forget that the trust is an abstraction, and that the economic pinch is felt by men of flesh and blood. Even so, the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions. • • • We do not pause to consider whether a statute differently conceived and framed would yield results more consonant with fairness and reason. We take the statute as we find it."

III.

Even if the Separate Identity of Trustee and Beneficiary Could Be Ignored, the Defense Does Not Meet the Tests Required of a Plea of Set-off or Recoupment, and There is No Equity in it.

(a) A barred claim for taxes is a nullity, the collection of which is forbidden by law.

It is not disputed that the time within which the United States could have proceeded against the widow under section 610 of the Revenue Act of 1928 (Appendix, p. 30) for the recovery of the erroneous refunds made to her for the years 1924 to 1927, inclusive, expired on September 17, 1933.[6] Nor is it disputed that, under section 275 of the same Act, any assessment for 1928 was barred about March 15, 1931.[7]

Had the Commissioner disregarded these limitations and proceeded thereafter to assess and collect his claims against the beneficiary, such payments by her would have been *overpayments*, refundable to her upon the filing of claim (sec. 607, Revenue Act of 1928, Appendix, p. 31), and such refund could not have been resisted on any plea of equity arising from the mere fact that the taxes should have been paid originally. Furthermore, if after such limitation expired, he had credited overpayments due her (or overpayments due the trustee) against such claims for additional taxes, the credit would be *void*, by express statutory provision (sec. 609(a), Revenue Act of 1928, Appendix, p. 31), and the taxpayer could recover the amount of the barred taxes collected by means of the credit, regardless of the original liability to pay the barred taxes. *United States* v. *John Gallagher Co.*, 83 F. (2d) 368 (C. C. A. 6th).

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[6] i. e., two years after such refunds were made.

[7] Return was due and presumably filed on or before March 15, 1929.

Thus after March 15, 1931, under plain statutory provisions, the Commissioner could not have exacted payment of any 1928 taxes from the beneficiary, either directly by collection, or indirectly by application of a credit of overpayments to her. And, after September 17, 1933, he was likewise prohibited from collecting any such claim for 1924 or 1925. In short, the beneficiary's liability was extinguished long before this suit was filed, and respondent has no valid claims against the beneficiary.

(b) Such a claim furnishes no basis for a plea of set-off or recoupment.

If the respondent has no claim enforceable directly or indirectly against the beneficiary, how may the plea here be sustained? Certainly not as a plea of set-off or recoupment. One against whom a set-off is claimed must be under a legal obligation to pay the amount of the set-off to the claimant or the set-off may not be allowed. *United States* v. *Irving Trust Co.*; 77 F. (2d) 852 (C. C. A. 2nd); *McGuire* v. *Gerstley*, 26 App. D. C. 193, aff'd 204 U. S. 489. If the claim is barred at the time the set-off is claimed, it may not be allowed. *McCarl* v. *Halstead*, 59 App. D. C. 395; D. C. Code, Title 24, sec. 413 (Appendix, p. 31).

Viewed as a plea of recoupment, the defense is not good, even if the separate identity of trust and beneficiary could be overlooked. There is no mutuality, in that the trustee could not "recoup" overpayments due the beneficiary against a demand for additional taxes from the trust. *Wynne* v. *Commissioner*, 77 F. (2d) 473 (C. C. A. 5th).

Another essential feature of a recoupment is that the claim must arise out of some feature of the transaction upon which petitioner's claim is founded. *Bull* v. *United States*, 295 U. S. 247, 262. The transaction which gave rise to petitioner's claims for 1924 and 1925 was the deposit of amounts, pending court review, which were demanded by respondent as taxes due from the trust. That demand

having been held illegal, section 1001(d) requires the return of the money. Likewise, the transaction which gave rise to petitioner's claim for 1928 was the payment by it of taxes in excess of those properly due by the trust. The respondent's claims for 1924-1927 arise out of erroneous refunds of money by him to the beneficiary, and his claim for 1928 arises from underpayment of taxes by the beneficiary for that year.

In the courts below it was argued that the "same transaction" which permits a plea of recoupment is the "taxation of the income of a testamentary trust distributed to the beneficiary." If this be a sound theory, it follows that an overpayment by the trustee for 1925 may be applied against a tax due from the beneficiary for 1927 or against any claim for a refund made to her under a mistake of law. By the same token, an overpayment by the beneficiary for 1930 may be defeated by a claimed deficiency of the beneficiary for the year 1920, without regard to statutory limitations, solely on the ground that the beneficiary received trust income in each of such years.* This contention overlooks the fact that the distributable trust income of the beneficiary is only one element in the computation of her taxable income. Income from other sources may greatly increase her tax, or statutory deductions having no relation to trust matters may reduce or entirely wipe out her taxable income. On the other hand, capital gains or losses of the trustee, seriously affecting its taxable income, have no effect whatever on her tax liability. *Anderson* v. *Wilson*, 289 U. S. 20. The trust estate's operation may show a deficit, but the beneficiary nevertheless is taxable on

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* Respondent has never contended that the doctrine of recoupment applies to the claims against the widow for 1926 and 1927, which aggregate $29,124.40 (R. 24), and which have no relation whatever to petitioner's demands which are for 1924, 1925 and 1928. Nevertheless, respondent does not limit his claims against the beneficiary to the same taxable years for which petitioner is entitled to refunds, and if his defense is sustained as a recoupment plea, it is necessary to find that the beneficiary's income for any given year grows out of the same transaction as her income (or the trustee's) not only for that year but for all years.

amounts distributed to him. *Jackson* v. *Price*, 74 F. (2d) 707 (C. C. A. 2nd).

Respondent's contention in this respect would make the statutory limitation on assessment and collection inoperative in the case of any taxpayer who receives income, year after year, from the same source, and section 609(a), *supra*, would be nullified.

We submit, therefore, that respondent's plea may not be sustained under any theory of set-off or recoupment.

(c) Such a claim has no basis in equity.

The Court of Appeals in the instant case, as we have said, agreed that there was no right of credit or set-off and did not base its decision on the theory of recoupment. The Court held that respondent neverthless could refuse to refund overpayments illegally exacted from the trustee, simply because he once had claims against the beneficiary which were not paid. In reaching this conclusion, the Court of Appeals used the following reasoning (R. 35):

> "Mrs. Brown owes the United States a large amount of money for taxes. The statute of limitations has intervened, and the government cannot collect. On the other hand, her trustee, Girard, has paid to the United States a large amount of money for taxes for which it is not liable and which the Board has determined it is entitled to recover. The money, however, which it mistakenly paid belonged to Mrs. Brown and, if recovered, will be payable to her; so that if we shall order the lower court to issue the writ, the result will be to require the United States to pay over money which—while technically that of Girard—actually would go to Mrs. Brown. Obviously, this is inequitable and ought not to be done unless required as a matter of law."

The decision that the Commissioner, although denied the right to credit an overpayment against a barred deficiency claim, may nevertheless defeat recovery of the overpay-

ment upon a mere showing that such a deficiency claim once existed, is untenable. Cf. *Graham* v. *Goodcell*, 282 U. S. 409, 423. To transfer funds illegally collected from the trustee to the account of the beneficiary, merely because they would be payable to the latter if refunded, is a distraint quite as well as would be a direct seizure of funds already in the latter's possession. *37 Col. Law. Rev. 148.*

The decision below rests squarely upon the proposition that an equity arose in favor of the government from the lack of diligence of its own officials, and sprang into being at the moment that this official inaction destroyed the liability in question. That is necessarily so, because the alleged equity rests upon the ground that collection from the beneficiary is barred, and there could be no such defense if it were not so barred. As to 1928, the respondent's defense, sustained below, presents this absurd situation: If the widow had paid the tax after limitation on assessment had expired, there would be no basis for respondent's plea, and he would be required to pay petitioner its demands. But, under section 607 of the 1928 Act, *supra*, the widow could then recover her payment on the ground that it was collected too late, and the result would be exactly the same as that which the court below denounced as inequitable. The result in each case flows from statutory provisions that official inaction over a stated period of time shall wipe out all liability for the tax. *Russell* v. *United States*, 278 U. S. 181, 187.

The real basis of the decision below, therefore, is that the operation of the statute of limitations produces inequitable results and that the statute may, for this reason alone, be ignored. The theory is that, at the moment the bar falls, and *because* it falls, an "equity" springs full-blown into being, which justifies the party so barred in effecting the collection of his defunct claim by an indirect method not theretofore available to him. If this view be sound, it was inequitable for this court to order refund, in *Bowers* v. *New*

York & Albany Lighterage Co., 273 U. S. 346, of taxes collected after the bar of the statute had fallen; and the result was inequitable when this court, on confession of error by the Solicitor General of the United States, reversed the decision of the Court of Claims (61 Ct. Cls. 363) in *Toxaway Mills* v. *United States*, 273 U. S. 781, where that court had expressed the view that the taxpayer could not recover such a collection unless it could show that "the government *ex aequo et bono* is bound to refund." (61 Ct. Cls. 373) See also *Brewerton* v. *United States*, 9 F. Supp. 503. (Ct. Cls.)

It was argued below that the equities favoring respondent were strengthened by the alleged fact that he did not know until this Court's decision in *Helvering* v. *Butterworth, et al.*, 290 U. S. 365, that he had a claim against the widow and that it was then too late to proceed against her. However, as the court below points out (R. 38), one United States Circuit Court of Appeals[9], within time for respondent to proceed under section 610 of the Revenue Act of 1928 against the beneficiary in the instant case, had held a widow subject to such tax in an identical case. Respondent was a party to that suit and therefore had ample notice of his rights. However, we submit that neither respondent's ignorance of the law nor his laches should create any equity in his behalf, and that a court may not disregard statutory limitations, as did the court below, simply because it feels that the observance of such limitations would produce inequitable results.

The rule for which respondent contends could never be invoked by a taxpayer possessed of the same "equities". He cannot enjoin the collection of an admitted tax liability upon a showing that he has a barred claim for refund. A trustee cannot resist a deficiency because of overpayments due the beneficiary of the trust, whether barred from refund or not. *Wynne* v. *Commissioner*, *supra*.

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[9] *Title Guarantee Loan & Trust Co.* v. *Commissioner*, 63 F. (2d) 621 (C. C. A. 5th), decided February 17, 1933.

The defense interposed rests upon the ground that the statute of limitations, designed to put an end to disputes, may be ignored wherever the barred claim was originally a valid one, leaving the statute to be enforced only where the alleged debtor is able to show that there was no debt and where, therefore, he is not in need of the protection of the statute.

IV.

A Taxpayer's Choice of Method of Procedure Upon Appeal from the Board of Tax Appeals Does Not Give the Commissioner Rights Which He Would Not Have Under the Alternative Method of Procedure.

Section 1001, Revenue Act of 1926, as amended (Appendix, p. 28) prescribes the method for judicial review of decisions of the Board of Tax Appeals. The taxpayer may file a surety bond and stay collection, or he may pay the deficiency pending review. If he adopts the latter course, either voluntarily or because he cannot secure an acceptable bond, and if the court disallows the deficiency determined by the Board, his payment is to be returned to him by credit or refund "without the making of claim therefor". The intention of Congress seems clear. Such a payment pending review is to be treated, as the court below said (R. 34-35), as a deposit in lieu of bond. If such deposit were entrusted to the clerk of the court, it can hardly be denied that, the taxpayer having won its case, the court would order the deposit returned. But the Court of Appeals holds that, because the custodian of the fund was also the officer charged with collecting taxes, he may retain the deposit and apply it against other claims, the collection of which has long since been outlawed. A parallel situation was presented in the case of *Morris Metcalf*, 16 B. T. A. 881, where a taxpayer offered to compromise a proposed deficiency and deposited $500 with the Commissioner for that purpose. The offer was rejected, but the Commissioner, after the statutory period for assessment

of the deficiency had expired, applied the deposit against the claimed deficiency. The Board held that this application of the money constituted a collection of a barred deficiency and therefore represented an overpayment of $500.[10]

The decision below recognizes (R. 37) that the erroneous refund to the widow could not have been set up as a defense in the Board proceeding. If, therefore, petitioner, instead of paying, had posted the bond permitted by section 1001 (c), "conditioned upon the payment of the deficiency as finally determined", the bond would have been satisfied by the decision of the Court of Appeals that no deficiency was due. The Commissioner then would have had no method of collecting his claims against the widow, who would have been "unjustly enriched" to the same extent as that here urged. The decision below therefore is clearly that petitioner's selection of one of the two alternatives offered by section 1001 gives the Commissioner a right, which he could not possibly possess if the first method were adopted, to convert the money to a use not contemplated by the parties nor mentioned in the statute.

If payment of a deficiency pending review is to lift the bar of the statute of limitations and place upon the taxpayer the burden of defending not only the immediate threatened imposition, but any and all barred claims for any year in the remote past that government officials might choose to assert, then the choice of procedure offered for the relief of taxpayers by section 1001 becomes a trap for the unwary. Such a doctrine makes a mockery of a judicial proceeding designed "to provide a final adjudication in such proceedings, binding all the parties." *Old Colony Trust Company* v. *Commissioner*, 279 U. S. 716, 727. The Board was created for the purpose of providing "a more convenient, more equitable, and more speedy remedy to a person against whom a tax is improperly assessed, and the

[10] This decision was rendered June 4, 1929, and the Commissioner has formally announced his acquiescence therein. *Int. Rev. Cumulative Bulletin VIII-2*, p. 35. (1929)

provision is to be liberally construed." *Houston Street Corporation* v. *Commissioner*, 84 F. (2d) 821, 822 (C. C. A. 5th).

The Board proceeding in the 1924-1925 case was a companion case (R. 34, footnote) to *Butterworth* v. *Commissioner*, 23 B. T. A. 838, 63 F. (2d) 944. (C. C. A. 3rd), 290 U. S. 365. Had the trustee in that case paid the tax instead of posting a bond on appeal from the Board, respondent could have refused to refund, and the prosecution of that appeal before the Circuit Court of Appeals and on certiorari in this Court would have been idle, under such a theory.

In the case of *Zellerbach Paper Co.* v. *Helvering*, 293 U. S. 172, the sole question presented was whether the statute of limitations barred assessment and collection of a deficiency proposed by the Commissioner. The Board of Tax Appeals (26 B. T. A. 96) held that it was not barred, and the taxpayer petitioned for review by the Circuit Court of Appeals for the Ninth Circuit which affirmed the Board's decision (69 F. (2d) 852). This Court reversed. If the taxpayer in that case had paid the tax pending review, the Commissioner, on the theory sustained by the court below in the instant case, could have refused to refund the amount so paid. The result in such event would be that, in an appeal taken for the sole purpose of determining the question of limitations, the court's decision that limitation had run could be set at naught by the Commissioner's opinion that it would be inequitable to honor that decision. The same absurd situation could have resulted in *Myles Salt Company* v. *Commissioner*, 49 F. (2d) 232, (C. C. A. 5th); *Goldmann Company* v. *Burnet*, 60 App. D. C. 265, 51 F. (2d) 427, and *Valentine-Clark Company* v. *Commissioner*, 52 F. (2d) 346, (C. C. A. 8th), where the respective courts of appeal reversed the Board on a similar question.

A procedure analogous to that prescribed by section 1001 is found in the statutory provisions relating to jeopardy

assessments.[11] Where such an assessment is made, and the taxpayer appeals to the Board of Tax Appeals, but is unable to stay collection by filing a satisfactory bond, if the Board thereafter determines the assessment to have been erroneous, the amount paid must be credited or refunded "without the filing of claim therefor." In such a situation, the Commissioner should have equally as great a right to refuse the refund because of a barred claim as in the instant case. If he has such a right, then the statute of limitations is indeed meaningless, because his determination of the need for a jeopardy assessment is not subject to judicial review (*The Foundation Company* v. *United States,* 15 Fed. Supp. 229 (Ct. Cl.)) and with this potent weapon he could make illegal collections at will.

CONCLUSION.

The judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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[11] Title 26, U. S. C. A., Sec. 273 and "Historical Note".